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Nos. 06-1010 and 06-1011

In the Supreme Court of the United States

NIAGARA MOHAWK POWER CORPORATION, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION

STATE OF NEW YORK, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission acted lawfully in approving and enforcing a transmission tariff under which generators of electric power may net their "station power" consumption against their power output on a monthly basis.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-13a) is reported at 452 F.3d 822.[1] The orders of the Federal Energy Regulatory Commission (Pet. App. 20a-32a, 33a-69a, 70a-95a, 96a-137a, 138a-159a, 160a-194a, 195a-219a, 220a-247a) are reported at 101 F.E.R.C. ¶ 61,230, 107

[1] Unless otherwise noted, all references to "Pet." and "Pet. App." are to the petition and appendix filed in No. 06-1010.

F.E.R.C. ¶ 61,142, 105 F.E.R.C. ¶ 61,337, 110 F.E.R.C. ¶ 61,032, 105 F.E.R.C. ¶ 61,336, 110 F.E.R.C. ¶ 61,033, 109 F.E.R.C. ¶ 61,169, and 111 F.E.R.C. ¶ 61,120.

JURISDICTION

The judgment of the court of appeals was entered on June 23, 2006. Petitions for rehearing (Pet. App. 14a, 15a, 16a-17a) were denied on October 23, 2006. The petitions for a writ of certiorari in No. 06-1011 and No. 06-1010 were filed on January 18 and January 22, 2007 (Monday), respectively. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Section 201 of the Federal Power Act (FPA), 16 U.S.C. 791a *et seq.*, gives the Federal Energy Regulatory Commission (Commission or FERC) jurisdiction over the "transmission of electric energy in interstate commerce," the "sale of electric energy at wholesale in interstate commerce," and "all facilities for such transmission or sale." 16 U.S.C. 824(b)(1). See *New York* v. *FERC*, 535 U.S. 1, 19-20 (2002). The States retain jurisdiction over "any other sale of electric energy" and "facilities used in local distribution" of electricity. 16 U.S.C. 824(b)(1).

"Historically, electric utilities were vertically integrated, owning generation, transmission, and distribution facilities and selling these services as a 'bundled' package to wholesale and retail customers in a limited geographical service area." *Public Util. Dist. No. 1* v. *FERC*, 272 F.3d 607, 610 (D.C. Cir. 2001). In 1996, the Commission adopted FERC Order No. 888, which directed public utilities subject to FERC's jurisdiction to offer non-discriminatory, open-access transmission ser-

vice.[2] To implement that directive, the Commission ordered the functional unbundling of wholesale generation and transmission services. See *New York*, 535 U.S. at 11. "Functional unbundling" requires each public utility to announce separate rates for its wholesale generation, transmission, and ancillary services. See *ibid.* Utilities also must take transmission service for their own wholesale sales and purchases under the same general tariff applicable to others, and they must separate their transmission and generation marketing functions and communications. See *ibid.* In its decision in *New York*, this Court upheld Order No. 888.

New York utilities went beyond the "functional unbundling" required by Order No. 888. After the order was adopted, utilities in New York "began divesting their generation facilities, and the vast majority of electricity generation in the state of New York is now performed by independent wholesale generators." Pet. App. 2a. Today, traditional utilities in New York maintain ownership of the transmission and local distribution facilities and provide retail service, while the not-for-profit New York Independent System Operator (NYISO) operates and controls the transmission grid. See *ibid.* The "merchant generators" who purchased the generation facilities divested by utilities have no

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[2] See *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 61 Fed. Reg. 21,540 (1996) (Order No. 888), clarified, 76 F.E.R.C. ¶¶ 61,009 and 61,347, order on reh'g, 62 Fed. Reg. 12,274 (Order No. 888-A), order on reh'g, 62 Fed. Reg. 64,688 (1997) (Order No. 888-B), order on reh'g, 82 F.E.R.C. ¶ 61,046 (1998) (Order No. 888-C), aff'd *sub nom. Transmission Access Policy Study Group* v. *FERC*, 225 F.3d 667 (D.C. Cir. 2000), aff'd *sub nom. New York* v. *FERC*, 535 U.S. 1 (2002).

retail-service obligation and sell wholesale power at market-based rates under FERC-approved tariffs. See, *e.g.*, *PJM Interconnection, L.L.C.*, 94 F.E.R.C. ¶ 61,251, at 61,883 n.12 (2001) (defining "merchant generator" as a "non-vertically integrated owner of generating facilities" that includes both independent and affiliated power producers).

2. These petitions arise from a set of FERC orders concerning the NYISO's treatment of "station power." Station power is "the electric energy used for the heating, lighting, air-conditioning, and office equipment needs of the buildings on a generating facility's site, and for operating the electric equipment" at the site. *PJM Interconnection*, 94 F.E.R.C. at 61,889. A generating facility may "self-supply" its station power "behind the meter" by redirecting some of its outbound generated electricity for its station power needs. See *id.* at 61,890. But in certain circumstances, a generating facility may be incapable of self-supplying station power and therefore may look to the transmission grid for its station power needs. See *ibid.*

When utilities were vertically integrated, the treatment of station power was not an issue. Utilities have a longstanding practice of treating station power as "negative generation" and netting station power needs when measuring the output of a generator. That is, utilities historically have not charged themselves, their affiliates, or their fellow utilities for station power, even for periods when the generating unit was not operating. See *PJM Interconnection*, 94 F.E.R.C. at 61,882, 61,886, 61,889-61,890 & n.56. Instead, they have simply treated the generator as if it produced only its net output—that is, its gross power output minus the station power it consumed.

The treatment of station power became a disputed issue upon the entry of non-traditional merchant generators into the market. Merchant generators sought to obtain and account for necessary station power service in the traditional manner employed by traditional utilities—by netting station power needs against gross output. See *PJM Interconnection, L.L.C.*, 95 F.E.R.C. ¶ 61,333, at 62,189 (2001). If netting were not allowed, a generator that was unable to self-supply "behind the meter" would have to pay for its station power at state-approved retail rates.

In the *PJM Interconnection* orders, FERC permitted the independent operator of the grid in the Pennsylvania–New Jersey–Maryland area to allow netting on an hourly basis. See 94 F.E.R.C. at 61,892. For example, a generator that used the grid to obtain its station power for fifty minutes but then returned a greater amount of power during the next ten minutes would be deemed to have supplied the net amount and to have consumed nothing.

The Commission explained that netting "will better ensure comparable treatment, and will address the concerns of the merchant generators that some vertically-integrated utilities are favoring their own or affiliated generating facilities to the competitive disadvantage of merchant generators." *PJM Interconnection*, 94 F.E.R.C. at 61,893. Because vertically integrated utilities "generally own more generating facilities than merchant generators do," they "may be able to self-supply more often than merchant generators and may never have to pay another utility's retail rates for third-party supply of station power." *Ibid.* Likewise, vertically integrated utilities own transmission lines between their generating facilities, so they may never have to pay a

third-party's charges for transmission of station power. See *ibid.* Allowing netting by merchant generators, the Commission concluded, would therefore "limit if not fully eliminate disparities between merchant generators and vertically-integrated utilities." *Ibid.*

3. In the orders at issue here, the Commission affirmed merchant generators' ability to net station power uses over a reasonable period of time so as to enable those generators to procure station power competitively. Specifically, the Commission found that the NYISO's decision to use a one-month netting period was reasonable. See Pet. App. 27a-29a, 86a-87a, 148a-151a, 217a-218a. Under that approach, no retail sale occurs—and thus no retail charge is permissible—when a generator's net output, measured over one month, is positive.

4. Petitioners—a group of electric utilities and the State of New York—sought review of FERC's orders. The court of appeals denied the petitions for review. Pet. App. 13a.

Petitioners argued that monthly netting violates the FPA because it allegedly encroaches upon state jurisdiction over local distribution services and retail sales. See Pet. App. 7a. The court of appeals acknowledged that, as an abstract matter, this argument was "not insubstantial." *Id.* at 9a. But it concluded that petitioners' position was fatally undermined by their "clear concession" that an hourly netting period would be consistent with the statute. *Ibid.*

The court explained that "some practical accommodation is necessary" in drawing the jurisdictional lines between interstate transmission (the grid) and retail sales. Pet. App. 9a. Petitioners objected to monthly netting "because it eliminates many—perhaps virtually all—of the station power transmissions" from the cate-

gory of retail sales subject to state jurisdiction, "and a shorter netting period would eliminate fewer." *Id.* at 10a. But under petitioners' reasoning, "*any* netting out of what it deems 'retail sales' over *any* period would amount to a statutory violation." *Ibid.* That result would be inconsistent with petitioners' view that hourly netting is acceptable. See *ibid.* The court concluded that "if hourly netting is perfectly consistent with the statute, we see no principled reason why monthly netting violates the Act." *Ibid.*

Petitioners also argued that FERC Order No. 888 explicitly acknowledged state jurisdiction over delivery services to "end users" and drew no distinction between the typical industrial end user, who is susceptible to retail charges, and a wholesale generator that takes power from the transmission grid. See Pet. App. 7a. The court rejected that argument, explaining that the term "end user" in Order No. 888 could reasonably be interpreted to contain an exception for a non-traditional wholesale generator. See *id.* at 11a. In addition, the court noted that "petitioners' concession equally undermines their argument based on Order 888," since "[i]f generators must be thought of as equivalent to industrial end users," then hourly netting would be just as improper as monthly netting. *Ibid.*

Finally, the court of appeals rejected petitioners' argument that the Commission's decision to allow netting on a monthly basis, rather than over some shorter period of time, was arbitrary and capricious. See Pet. App. 11a. After examining FERC's explanation that "netting is necessary in order to put wholesale generators in roughly the competitive position integrated utilities enjoy," and petitioners' claim that "this competitive concern is really irrelevant in the New York market,"

the court concluded that "we simply do not see, on these arguments, how we could determine that a one-hour, a one-month, or for that matter a one-week netting period is unreasonable." *Id.* at 12a.

ARGUMENT

In the orders at issue here, FERC acted reasonably to prevent discrimination against merchant generators that do not own electrical transmission facilities. The court of appeals correctly upheld the Commission's orders. Its decision is consistent with this Court's interpretation of the FPA in *New York* v. *FERC*, 535 U.S. 1 (2002), and it does not conflict with any decision of this Court or any other court of appeals. Petitioners argue that the court of appeals allowed FERC to assert jurisdiction over retail sales of electricity, a matter reserved to the States. That contention lacks merit and in any event would not be suitable for resolution in this case, because petitioners' concession in the court of appeals fatally undermined the logical premise of their argument. Further review is not warranted.

1. FERC's orders were a reasonable effort to ensure that non-traditional utilities—merchant generators without transmission facilities or a retail customer base—are not subject to undue discrimination at the hands of traditional utilities, in contravention of the nondiscrimination mandate of Sections 205 and 206 of the FPA, 16 U.S.C. 824d and 824e. See *New York*, 535 U.S. at 6-7 (FERC is obligated under FPA Sections 205 and 206 to prohibit and remedy any unreasonable rates and undue discrimination "with respect to any transmission or sale subject to the jurisdiction of the Commission."). The court of appeals correctly upheld the Commission's action.

Historically, vertically integrated utilities netted out their station power needs. There was no need for FERC approval of such practices when services were bundled and utilities did not have to provide or take unbundled transmission service under open-access transmission tariffs. The transmission tariff that the Commission approved in this case simply affords merchant generators the same right to net their station power needs against their gross output that was historically afforded to New York utilities. The Commission has "never required that net output be measured on a real time or second-by-second basis"; rather, it always has allowed net output to be "measured over a reasonable time period, so as to take into account fluctuations in electric production." *PJM Interconnection*, 94 F.E.R.C. ¶ 61,251, at 61,892.

In accepting and enforcing the New York transmission-tariff provision that permits netting, the Commission acted to "eliminat[e] disparities between merchant generators" and other New York utilities. Pet. App. 28a; see *id.* at 52a ("netting is simply the traditional accounting for station power as negative generation"). A non-traditional merchant generator unable to net its station power needs, and forced to pay a retail rate for retail service it neither wants nor receives, would be placed at a competitive disadvantage in comparison with a traditional utility—like the former owner of the divested generator—that incurs no such additional charge. See, *e.g.*, *id.* at 192a (Commission acted to "permit[] merchant generators to compete fairly with utilities for customer load, fostering competition in electricity markets").

The court of appeals understood that the Commission has an obligation under the FPA to foster competitive,

non-discriminatory utility practices and to remedy undue discrimination. It properly traced the evolution of markets in New York, including the divestment of "the vast majority of electricity generation" in that State by "traditional utilities," which still "maintain ownership of the transmission and local distribution facilities," to "independent wholesale generators." Pet. App. 2a; see *id.* at 11a (wholesale generator is a "new creature in the market," one that is "in a quite different position from a retail user"). It recognized the Commission's reasoning that netting would "reduce the disparities between wholesale generators and vertically-integrated utilities." *Id.* at 6a. And it agreed with the Commission that the potential for such disparities continues to exist in New York, as New York merchant generators still compete with traditional New York utilities that either own generation capacity or that purchase generation for resale, as well as with merchant generators and traditional utilities in neighboring regions. See *id.* at 12a. In sum, the court of appeals properly appreciated the evolving nature of the electricity markets and the Commission's traditional regulatory responsibilities as applied to those markets. See *New York*, 535 U.S. at 23 (recognizing "the importance of the changes in the electricity industry that have occurred since the FPA was enacted in 1935").

2. Petitioners argue (Pet. 15-25; 06-1011 Pet. 18-19, 23-25) that the court of appeals has sustained an order that exceeds FERC's statutory authority under the FPA. In their view, the Commission has improperly intruded on state authority over retail sales. Petitioners are incorrect. Far from ousting the States of their jurisdiction over retail sales of electricity, the court confined

both FERC and the States to their respective jurisdictional roles under the FPA.

The court of appeals correctly recognized that regulatory jurisdiction over electricity is "split between the federal government and the states." Pet. App. 2a. Citing Section 201(b)(1) of the FPA, 16 U.S.C. 824(b)(1), FERC's open-access transmission rulemaking in Order No. 888, and this Court's decision upholding that rulemaking in *New York*, the court of appeals accurately described the division of jurisdictional authority between the federal and state governments: (1) "FERC has jurisdiction over both the interstate transmission of electricity and the sale of electricity at wholesale in interstate commerce," while (2) "States retain jurisdiction over retail sales of electricity and over local distribution facilities." Pet. App. 2a-3a; accord *New York*, 535 U.S. at 17.

Focusing on the statutory recognition of authority for the States to regulate local distribution service and retail sales, petitioners argue (Pet. 13-15; 06-1011 Pet. 21-22) that the decision below sanctions FERC encroachment on state regulation. They contend that FERC's approval of monthly netting of station power undermines the States' discretion and policy to limit netting to just one hour or shorter. See *id.* at 14-17.

Petitioners' argument begs the question. By enacting the FPA, Congress allowed FERC effectively to limit state regulatory authority when FERC acts within its jurisdiction. See, *e.g.*, *Entergy La., Inc.* v. *Louisiana Pub. Serv. Comm'n*, 539 U.S. 39, 49-51 (2003). Under the statute, FERC's jurisdiction extends to the "sale of electric energy at wholesale in interstate commerce" and "all facilities for [interstate] transmission or sale." 16 U.S.C. 824(b)(1). To exercise its jurisdiction, the

Commission must define when a wholesale sale occurs and when the facilities of interstate transmission are used to transmit power. In the orders at issue here, FERC did just that. Those orders reflect FERC's judgment that when a generator produces power but also consumes a smaller amount of station power during the netting period, it has engaged in a single "sale of electric energy at wholesale," and it has used transmission "facilities" only for that sale. 16 U.S.C. 824(b)(1). As the Commission explained, it is not "intrud[ing] into state jurisdiction over retail rates or local distribution services," but only "determin[ing] based on applicable law and fact what type of services (wholesale or retail) are actually being provided." Pet. App. 173a.

As the court of appeals recognized, the problem FERC confronted is essentially one of line drawing: "[I]n drawing the jurisdictional lines in this area, some practical accommodation is necessary." Pet. App. 9a. See *New York*, 535 U.S. at 16 (noting that "the electricity universe" is not "neatly divided into spheres of retail versus wholesale sales") (quotation marks omitted). The Commission's reasonable line-drawing in this area is entitled to deference. See *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837, 842-844 (1984); *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, 487 U.S. 354, 380-382 (1988) (Scalia, J., concurring) (*Chevron* deference applicable to agency's interpretation of its own statutory authority or jurisdiction); see, *e.g.*, *NLRB* v. *Town & Country Elec., Inc.*, 516 U.S. 85, 89 (1995); *CFTC* v. *Schor*, 478 U.S. 833, 844 (1986).[3]

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[3] Petitioners assert (Pet. 22-25) that the decision of the court of appeals is inconsistent with Section 212(h) of the FPA, 16 U.S.C. 824k(h). Petitioners do not allege that there is any conflict on this issue. In any event, their argument lacks merit because it is essentially

3. Petitioners argue (Pet. 11; 06-1011 Pet. 19) that the decision below is inconsistent with this Court's decision in *New York*. In fact, *New York* supports the decision of the court of appeals.

In *New York*, the Court held that FERC may draw reasonable lines to define the extent of its jurisdictional authority over wholesale sales and interstate transmission. 535 U.S. at 16-17. In particular, the Court determined that there is no statutory limitation on FERC's ability to define its jurisdiction over transmission in interstate commerce, see *id.* at 16, and that FERC's transmission jurisdiction extends at least as far as unbundled retail transactions, *id.* at 18. See *id.* at 27 (FERC jurisdiction "could very well" extend further to regulation of bundled retail transactions upon a finding of "undue discrimination in the retail electricity market"). Indeed, this Court, while recognizing that FERC does not have jurisdiction over local distribution service and facilities, accepted FERC's identification of a seven-factor test for distinguishing between FERC-jurisdictional transmission and state-jurisdictional local distribution. See *id.* at 22-23.

The fact that FERC is able to identify and define state-jurisdictional services, in order to distinguish those services from FERC-jurisdictional services, does not mean that FERC is able to assert jurisdiction over all defined services. See *New York*, 535 U.S. at 22-23. Here, the Commission assured petitioners that it has no intention of encroaching upon traditional state jurisdiction. See, *e.g.*, Pet. App. 26a-27a ("Any delivery of station power over local distribution facilities, and the com-

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derivative of their theory that the provision of station power to a generator is a retail sale even when that power is netted out by the generator's output.

pensation for such delivery is a matter properly for the New York Commission and not for this Commission.").

All that FERC did in these proceedings was to approve and enforce a FERC-filed transmission tariff that defines the amount of FERC-jurisdictional service a wholesale generator is receiving. More precisely, the Commission approved and enforced a definition of service under a FERC tariff that nets over one month the amount of electric power a wholesale generator both offers to the transmission grid and takes from the grid. Consistent with its earlier orders on the subject of netting, the Commission found that monthly netting in New York represented a reasonable period of netting. That action—and the decision of the court of appeals upholding it—was in no way inconsistent with *New York*.

4. Even if the question presented otherwise merited review, this case would be a poor vehicle for considering it because petitioners conceded away an essential premise of their argument when they acknowledged, before the court of appeals, that FERC would have the authority to allow netting over a one-hour period. See Pet. App. 9a-10a. No logical distinction separates netting over one hour and netting over one month. Thus, if hourly netting does not violate the FPA, then neither does monthly netting.

Petitioners contend (Pet. 26-27) that the court of appeals misunderstood the nature of their concession. Even if petitioners were correct, that case-specific question would not warrant review. In any event, the court's conclusion was amply supported by the statements of petitioners' counsel at argument. See 06-1011 Pet. App. 90a, 107a, 113a-116a. And contrary to petitioners' suggestion (Pet. 25-27; 06-1011 Pet. 13-14), the court of appeals did not view petitioners' willingness to accept

hourly netting to be a concession to jurisdiction where none otherwise exists. Rather, the court understood petitioners' concession as undermining the logic of their argument. See Pet. App. 9a. Since petitioners failed to present a cogent explanation of how the agency erred, the court appropriately upheld its orders. Cf. *Carducci* v. *Regan*, 714 F.2d 171, 177 (D.C. Cir. 1983) (Scalia, J.) ("The premise of our adversarial system is that appellate courts do not sit as self-directed boards of legal inquiry and research, but essentially as arbiters of legal questions presented and argued by the parties before them.").

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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